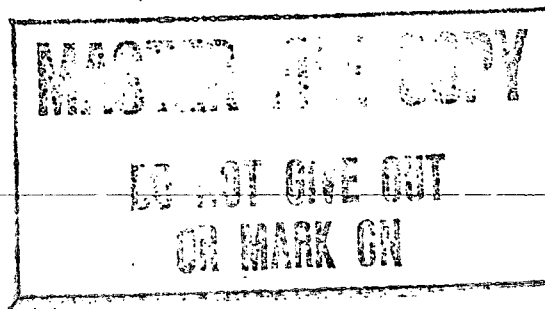




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# Hawke's Australia: Groping for an Industrial Policy

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An Intelligence Assessment

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EA 83-10178  
September 1983

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# **Hawke's Australia: Groping for an Industrial Policy**

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**An Intelligence Assessment**

This paper was prepared by [ ] Office  
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welcome and may be directed to the Chief,  
Southeast Asia Division, OEA, [ ]

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*EA 83-10178*  
*September 1983*

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**Hawke's Australia:  
Groping for an Industrial Policy**

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**Key Judgments**

*Information available  
as of 1 September 1983  
was used in this report.*

Years of protectionism, labor unrest, and slow productivity growth have left Australian manufacturing uncompetitive in world markets and highly vulnerable to import competition. High levels of protectionism have also taken a heavy toll on the economy by raising domestic prices—sometimes double the average prices for comparable products elsewhere in the industrialized West—and reducing growth. As a result, Australian living standards have declined relative to other developed countries.

Prime Minister Hawke has begun developing an industrial policy to reshape the manufacturing sector. As a former labor official and close friend of many leading businessmen, he is uniquely qualified among Australian politicians to deal with the country's economic problems. Hawke defines "industrial policy" broadly to include both a price and incomes policy to control wages, which affects all industries, and sectoral policies to protect individual industries from import competition.

Hawke has extended former Prime Minister Fraser's wage freeze by several months and has convinced unions and business of the need to return to a system of wage indexation. He is using protectionist policies on a piecemeal basis to aid Australian industry. Political pressures from unions and business have so far outweighed the arguments of many Australian Government "technocrats" who believe that gradual reductions in protectionism are necessary to make domestic firms competitive in export markets.

Any evolving industrial policy during the 1980s, however, faces a tough political road at home. According to the technocrats, liberalizing trade policy would provide numerous benefits to the Australian economy, including forcing firms to reduce costs and increase efficiency. If Canberra follows this course, Australia could increase exports to the dynamic economies of East Asia, providing an engine of growth well into the 1990s. On the other hand, increased exports to East Asia would require some commensurate increase in Australia's imports, which would produce a shakeout in the manufacturing sector and a permanent loss of some existing jobs.

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We believe this dilemma will probably continue to rule out any successful reforming of trade policy and the fashioning of an industrial policy as well. Under these circumstances, Prime Minister Hawke—and probably his immediate successors—will find Australia's growing lack of industrial competitiveness an increasingly nettlesome political as well as economic problem.

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**Table 1**  
**Australia: Forms of Import Protection**  
**to Manufacturing**

Type	Description	Comment
Tariffs	Mainly in the form of a percentage rate of duty, which is added to the import price.	Principal form of assistance to manufacturing.
Countervailing and antidumping duties	Imposed when the government determines that foreign firms are using unfair trade practices.	Substantial growth in the number of complaints received by the Customs Service in the past year, particularly from the chemical industry.
Quantitative import restrictions	Usually in the form of import licensing or as tariff quotas, in which a duty is applied if imports exceed a quota.	Intended as a measure of last resort. Automobiles and some steel products are protected in this way.
Differential sales tax	When applied, domestic goods are exempt from sales tax.	Products assisted in this way include beer, wine, cider, and fruit juices.
Subsidies and bounties	Payments to domestic producers. Bounties are usually figured as a percentage of the import price, and a payment is made for each unit of import.	Compared with tariff assistance, subsidies and bounties keep down costs to consumers. Recently applied to the steel industry.

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**Table 2**  
**Australia: Average Rates of Assistance**  
**to Manufacturing**

Industry	Nominal Rate <sup>a</sup>				Effective Rate <sup>b</sup>			
	1977/78	1978/79	1979/80	1980/81	1977/78	1978/79	1979/80	1980/81
Food, beverages, and tobacco	6	8	7	4	8	12	9	9
Textiles	22	25	25	26	48	49	51	57
Clothing and footwear	65	65	63	63	140	140	144	144
Wood, wood products, and furniture	33	12	11	11	18	17	15	14
Paper, paper products, printing and publishing	15	16	15	14	25	28	26	25
Chemicals, petroleum and coal products	11	11	10	8	19	19	18	15
Nonmetallic mineral products	5	5	5	5	6	6	6	6
Basic metal products	6	6	6	6	11	12	11	10
Fabricated metal products	20	21	20	20	31	32	32	34
Transport equipment	34	35	39	40	71	76	91	94
Other machinery and equipment	15	16	16	16	16	19	20	21
Miscellaneous manufacturing	20	20	20	22	24	25	26	29
<b>Total manufacturing</b>	<b>15</b>	<b>15</b>	<b>15</b>	<b>14</b>	<b>23</b>	<b>24</b>	<b>24</b>	<b>24</b>

<sup>a</sup> Nominal assistance refers to the assistance provided to an industry's output and is expressed as a percentage of the value of output.

<sup>b</sup> Effective assistance is a net measure of assistance to an industry, taking into account assistance measures affecting both inputs and outputs, and is expressed as a proportion of value added.

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## Hawke's Australia: Groping for an Industrial Policy

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### Hawke's Inheritance

Prime Minister Hawke's government inherited a stagnating and internationally uncompetitive manufacturing sector. The sector's shortcomings have long been a hot political issue because of concerns about employment, national pride, and national security. During the election campaign in early 1983, Hawke criticized the former Fraser government's poor record in developing policies for manufacturing, and we believe Hawke recognizes his own failure to do so would become a political liability. He has therefore tried to head off potential criticism by repeatedly making speeches since assuming office outlining the seriousness of the problem and suggesting that solutions will take time.

In our judgment, recent governments have avoided tackling the sector's major problems and instead have applied "band-aids" to troubled industries, usually by erecting stiff barriers to imports (see table 1). Although both Hawke's Labor Party and the opposition Liberal Party agree that a more competitive manufacturing sector requires reductions in import barriers, little progress has been made since a 25-percent across-the-board tariff cut was made in 1973 under the last Labor government. Despite public statements to continue to seek lower import restraints, the Whitlam (1972-75) and Fraser (1975-83) governments further protected selected industries, citing high unemployment and increasing foreign restrictions on Australian exports as justification. In our opinion, however, political pressures from unions and business were largely responsible for the policy decisions. Successful lobbying by the textiles and transport equipment industries for added import protection during the Fraser administration, for example, pushed up average rates of assistance to these industries (see table 2). Assistance to the chemical industry, on the other hand, fell during the late 1970s, and as a result the industry has recently become the leader in filing antidumping complaints with Canberra.

Note: All figures are in US dollars.

### Australia: Manufacturing at a Glance

- *Manufacturing accounts for 20 percent of gross domestic product and nearly 30 percent of the value of exports. New Zealand, the United States, the United Kingdom, and Japan are the largest overseas markets for Australian manufactures—together taking nearly 40 percent of manufactured exports in 1982.*
- *Australia has a broad industrial base, producing products ranging from base metals to processed food and from complex electronic devices to household appliances.*
- *The 1.2 million workers in the manufacturing sector make up nearly 17 percent of the labor force. They are heavily unionized, nearly 70 percent hold "blue-collar" jobs, and the largest number are employed in food-processing activities.*
- *Nearly 40 percent (\$3.3 billion) of US direct investment in Australia is concentrated in the manufacturing sector, largely in heavy machinery, chemicals, and transportation.*

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In any event, legacies of Canberra's efforts to protect the manufacturing sector include some of the highest tariffs and consumer prices among the developed countries. According to a US banking study, Australia has one of the most protected markets in the OECD,<sup>1</sup> and in some cases domestic prices for manufactured goods are more than double the average prices for comparable products elsewhere in the industrialized West.

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<sup>1</sup> The Organization for Economic Cooperation and Development.

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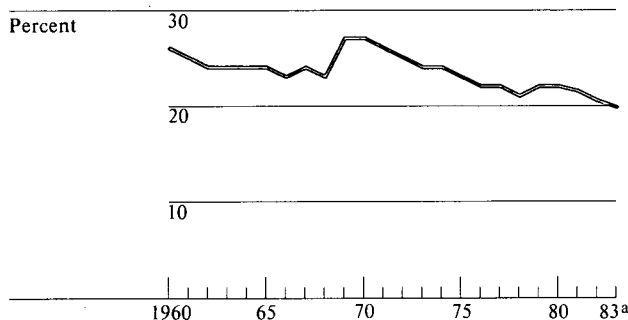
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**Figure 1**  
**Australia: Manufacturing as a Share of GDP**

<sup>a</sup> Estimated.

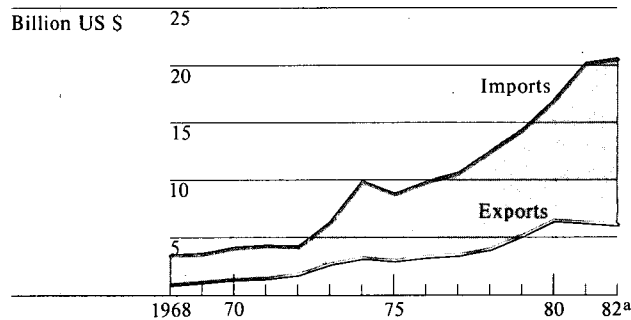
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### Industrial Performance in Perspective

In the 1930s, when Australia was producing only a limited range of manufactured goods, tariffs were established to assist the growth of import-competing industries. In the postwar period, such protection was maintained or increased—usually in the form of quantitative import restraints. Successive governments in the late 1950s and 1960s continued this practice with the goal of establishing an industrial base capable of providing employment for the rapidly growing labor force, and they were largely successful. At 1.5 to 2.5 percent, unemployment rates in the 1960s and early 1970s remained well below the average among developed countries, according to data published by the OECD.

Rapid expansion of the manufacturing sector came to an abrupt end in the early 1970s. After growing an average of 5.5 percent annually during 1962-73, growth of manufacturing output slowed to just over 1 percent a year between 1974 and 1980. Since 1980, the global recession has added to the manufacturing sector's problems, with production in early 1983 running 13 percent below the 1980 level. Manufacturing's share of national output has thus declined sharply, and at 20 percent of gross domestic product is now lower than that of several developing countries in Asia, including Singapore, Thailand, and the Philippines (see figure 1). Manufacturing employment in

**Figure 2**  
**Australia: Trade in Manufactures**

<sup>a</sup> Estimated.

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1980 was 10 percent below the level recorded a decade earlier and has declined another 7 percent since then because of the recession.

Before the global recession, a large part of the slow growth in manufacturing output resulted from stiff increases in import penetration, particularly from Japan and the ASEAN countries. During the 1970s, Australia's manufactured imports from ASEAN alone grew at a faster rate than from any other region, expanding at a 25-percent annual rate. During 1979-82 Australia's manufactured imports soared more than 40 percent while exports remained virtually flat (see figure 2). According to the OECD, part of the recent decline in Australia's international competitiveness and the surge in imports also resulted from the large foreign capital inflows associated with developing Australia's rich mineral resources. These inflows raised the value of the Australian dollar in 1980 and 1981, artificially cheapening imports and hurting exports.

### The Problem Areas

**Labor Productivity.** As in most other developed countries, labor productivity in Australia's manufacturing sector suffered during the 1970s. After growing by an average of just under 4 percent per year during 1960-73, the rate of growth in labor productivity—as

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measured by output per worker—slowed to under 1.5 percent during 1974-82, compared with the OECD performance of 2.5 percent annually. The reasons for the slowdown were varied, but our analysis reveals three underlying developments:

- Until the resource investment boom of the late 1970s, real investment in manufacturing grew slowly, largely because of high interest rates and a decline in profit performance. Profits declined from an average of 34 percent (as a share of the value of output) in the late 1960s to 25 percent during the mid-1970s, according to Australian Government data.
- High and variable rates of inflation during the 1970s also cut into labor productivity growth by eroding tax deductions for depreciation, which in turn restricted the growth of capital invested per worker.
- Rapid increases in energy prices that took place during the 1970s caused a shift to more labor-intensive production, and, consequently, labor productivity suffered.

Productivity trends, however, have varied widely between industries. The textile industry, for example, has improved labor productivity at a relatively rapid pace, averaging 4.5 percent during the 1970s. We believe this reflects the import-forced exit from the industry of firms with below-average labor productivity as the number of firms in the industry declined by 30 percent. Traditional heavy industries performed poorly, however. Transport equipment, basic metal products, and fabricated metal products, for example, all experienced very slow growth in labor productivity, with fabricated products actually showing a small average annual decline over the past 10 years.

**Strikes.** In our opinion, Australia's manufacturing sector's most critical problem is that it is served by one of the more volatile labor forces in the world. Nearly 55 percent of the sector's work force belongs to any one of several hundred different unions; firms must often negotiate with several unions at once. In some of the larger industries, it is not uncommon to find as many as 15 to 20 unions operating in a single

plant, according to the US Embassy. In addition, most unions are trade based, such as the 160,000-member Metalworker's Union, with members in manufacturing operations ranging from autos to ship-building, rather than industrial based.<sup>2</sup> As such, strikes often affect production in a wide variety of industries.

Overall, Australia has by far more disputes per worker than any other comparable developed country and ranks near the top in time lost to strikes per worker, according to the OECD. During the late 1970s, more disputes arose in manufacturing industries than in any other sector, and time lost to strikes in manufacturing accounted for almost half of the national total.

**Wage Setting.** Labor turmoil coupled with Australia's unique system of legal arbitration for fixing wages and settling industrial disputes has, we believe, led to excessive wage increases. Under the system, lawyers argue for their union and industrial clients before judges of the Australian Conciliation and Arbitration Commission,<sup>3</sup> who have traditionally attempted to ward off strikes even at the cost of higher wage settlements.

the Commission has generally acted to protect workers' interests, which in recent years has meant awarding large wage increases to offset Australia's high inflation, producing a wage-price spiral. According to government statistics, average wages in 1980-82 rose 16 percent a year, far in excess of the average 10.5-percent inflation rate. This practice helped to push wage rates in manufacturing up at an average annual rate of 13 percent in the 1970s—nearly 2 percentage points above the OECD average. Labor costs have been running ahead of productivity for most of the past five years and, according to an Australian banking study, are in large part responsible for Australia's loss of international competitiveness.

<sup>2</sup> Unions in the United States, for example, are generally industrial based, such as the United Auto Workers.

<sup>3</sup> The Commission is empowered to prevent or settle interstate industrial disputes, and its decisions are enforceable by law. It can enter disputes—usually dealing with such issues as wages and hours of work—on its own initiative or in response to the application of one of the parties to the dispute.

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**Australian Labor Party's Industrial Policy**

*During the election campaign early in 1983, the Australian Labor Party (ALP) and Bob Hawke attacked the former Fraser government for presiding over the near demise of the Australian manufacturing sector. At the same time, the ALP presented its own industrial policy to the electorate. Overall, the policy is more interventionist than was the Fraser government's and, in our judgment, will rely heavily on government assistance and protection measures. Labor's program encompasses, among other things, government financial aid for industry, investment incentives, and promoting "sunrise" industries:*

- **Finance:** *The ALP argues for the establishment of an Australian Industry Development Bank (AIDB) with sufficient capital and access to funds to enable it to stimulate and encourage the restructuring and revitalization of domestic industry. The AIDB would be able to purchase shares of equity capital, acquire convertible debt, and make or guarantee loans.*
- **Investment:** *Labor promised to continue former Prime Minister Fraser's accelerated depreciation allowance program.*
- **Sunrise Industries:** *The ALP promised to attempt to foster high-tech industries, such as biotechnology, computer software, computer chips, lasers, and*

*medical technology. Since taking office, Minister for Science and Technology Barry Jones has tirelessly pursued this theme.*

- **Research and Development:** *The policy states that Labor will attempt to double R&D spending over the next 10 years, from the current level of some \$250 million. The present industrial research program will be revised and extended so grants are nontaxable and the government could participate through equity or loans rather than grants alone.*

[REDACTED]

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*The ALP also has promised to combat foreign competition by:*

- *Refraining from reductions in protectionism while widespread unemployment prevails.*
- *Strengthening antidumping procedures.*
- *Speeding up Temporary Assistance Authority reviews and warning importers that additional imports negotiated during the review process may be subject to penalties.*
- *Introducing a foreign tax credit system for company income earned overseas to help counter tax incentives now available to Australian firms to relocate in low-tax countries.*

[REDACTED]

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In the past, unions have used their bargaining strength to fight off government attempts to control wages. For example, in 1981, organized labor bucked the Fraser government's wage indexation scheme, which was holding down real wage increases. Protests from unions, work stoppages, and a national telecommunications strike forced the abandonment of the policy. In late 1982, Fraser tried again to hold down wage increases by imposing a 12-month public-sector wage freeze and convincing the Arbitration Commission to freeze private-sector wages for six months. We believe Fraser wanted to use the recession to try to force unions to accept a cut in real wages and thus

break the wage-price spiral.<sup>4</sup> Although union officials opposed the freeze, the rank and file would not support strikes against it because they were more concerned about job security. [REDACTED]

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**Hawke's Approach**

Although the Labor Party is on record in support of a fairly ambitious industrial policy, Hawke has thus far been forced to be practical in developing policies for the manufacturing sector. Like Fraser, Hawke is concentrating his efforts on getting wages under control. At the same time, he is attempting to placate organized labor with selective protectionism—a policy consistent with his campaign promise to combat foreign competition while unemployment remains high. He is also drawing union officials and members of the business community into the decisionmaking process, both at a postelection economic summit designed to achieve a consensus on policies to deal with the recession and by appointing several union and business officials to his new Economic Planning Advisory Council, a group that is chaired by Hawke and provides policy advice directly to the Cabinet. [ ]

Although statements by senior government officials indicate that Hawke may view additional import restraints as short-term “stopgap” measures, which are necessary only until wages and inflation are brought into line with other developed countries, he is under pressure from unions, the business community, and several state governments to increase protection to protect jobs. According to the US Embassy, the Metals Trade Industry Association has launched a vigorous campaign to toughen Australia's dumping and subsidy legislation. Australian manufacturers of textiles, clothing, and footwear are pressing Canberra hard for a 25-percent cut in imports during the current fiscal year. Auto manufacturers and unions are seeking quota restrictions and increased duties or an 85-percent domestic content rule for light commercial vehicles. [ ]

For its part, the Hawke government argues that the current economic situation requires strong action to prevent further job losses, and we believe the Labor government after six months in office is amenable to demands from business and unions for more trade protection. Canberra's recent decision to aid the domestic steel industry may be a harbinger of this policy, in our opinion. Within the Cabinet, we expect Minister of Trade Lionel Bowen—dubbed “Minister for Protection” by some US Embassy officials—to be a strong supporter of protectionist measures. This view, however, is not unanimous within the Cabinet.

Foreign Minister Hayden, for example, recently attacked the various forms of domestic protectionism as “embalming geriatric industries in the formaldehyde of protection.”<sup>5</sup> Hayden's position, however, appears to us to be a minority one within the Cabinet. [ ]

Although using selective protectionism, Hawke has identified excessive wage increases as the primary cause of Australia's stagnating industries and has pinned his economic recovery program on getting wages under control. The cornerstone of this effort was Hawke's economic summit in April. According to the US Embassy, the summit was a major political success for Hawke. He effectively used it to lower expectations of an early economic recovery from the domestic recession or any substantial reduction in the 10-percent unemployment rate. Using his personal friendships with many corporate and business leaders, Hawke was able to obtain concessions from both unions and business. The Australian Council of Trade Unions agreed that Hawke's campaign promise to maintain real wages was not appropriate with unemployment above 10 percent. For their part, business leaders agreed to return to a system of wage indexation.<sup>6</sup> [ ]

Hawke has continued to build on the momentum generated at the summit. We believe his influence was instrumental in the Arbitration Commission's decision early in the summer to extend the wage freeze until at least September, when the government has hinted wages will probably be increased by 4 percent and then fully indexed to inflation, which is currently running 8.6 percent at an annual rate. This represents a compromise on the part of organized labor, which had been arguing for full cost-of-living increases for 1983. [ ]

<sup>5</sup> Although Hayden was addressing a subject outside his Cabinet portfolio, his views on foreign trade do carry some weight, according to the US Embassy. With academic training in economics, he was Treasury Minister under the Whitlam government. [ ]

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**Manufacturing and Protectionism:  
A Case Study**

*The Australian steel industry, which is dominated by Australia's largest company, Broken Hill Proprietary (BHP), has a history of financial problems. Steel production, which remained essentially flat during 1973-82, sank 26 percent during the 1982/83 fiscal year to 5.3 million metric tons. BHP has laid off 35 percent of the work force from its iron and steel plants in the past two years. According to press reports, both the company and the Australian Government recognize that the industry is uncompetitive in international markets. At 215 metric tons, steel output per worker per year ranks among the lowest in the world, according to the US Embassy.*

*During the past several months, BHP has pushed the Labor government for increased protection to give the company time to put its cost structure in line with foreign producers. The company asked the Hawke government to assure it of at least 85 percent of the Australian market and requested special tax incentives, including an immediate tax writeoff on new investments—a policy that would cost Canberra over \$20 million a year in lost tax revenue. According to Embassy reporting, the company threatened the Hawke government that it would virtually abandon its \$2.5 billion, 10- to 15-year investment modernization program if the government refused the request for additional protection.*

*The recently approved government plan for the industry consists of commitments from Canberra, organized labor, and BHP. The government will provide*

*\$63 million in bounty payments per year to steel users and will apply quotas on LDC steel producers to assure BHP between 80 and 90 percent of the Australian market. If BHP's share should fall below 80 percent, additional quotas or higher tariffs will be imposed. The company itself is a major beneficiary of the bounty, via payments to its steel-processing affiliates. For its part, BHP has agreed to invest \$700 million over the next five years to boost productivity and will provide job security for the existing work force. The investment, however, is less than BHP originally planned to spend and, according to the US Embassy, possibly indicates that BHP has again revised the projected future level of steel demand downward. Unions, meanwhile, have agreed to keep wages within the government's incomes accord.*

*Although the additional assistance will aid the industry in the short term, we believe it will impose a heavy cost on the economy. Most importantly, the assistance package will hurt metal-fabricating industries, such as sheet metal products and household appliances. According to the Australian Industries Assistance Commission, which recommended against long-term assistance, and the Bureau of Industry Economics, the additional protection will result in job losses in these industries that will exceed the jobs saved at BHP.*

In our judgment, Hawke's victories on the wage front also reflect the current disarray within the labor movement. For the most part, high unemployment has frightened unions into accepting Canberra's wage policy and deterred them from striking, according to press reports. In the steel industry, for example—which has laid off 16,000 steelworkers in the last two years—there has been no major work stoppage since early 1981, and no push for a wage hike for a year. According to a press report, one militant branch of

the Federated Iron Workers Association can get only 400 to 500 workers out of a membership of 11,500 to show up for meetings.

**The Upcoming Policy Debate**

Even if Hawke does make progress on wages, his government will face a tough decision on the future of protectionism. Within the government a group of

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**Table 3**  
**Australia: Key Government Agencies**  
**Involved in Industrial Policy**

Agency	Function	Comment
Department of Industry and Commerce	Advises the Prime Minister on all matters relating to the manufacturing industry.	The focal point for industrial policy.
Bureau of Industry Economics	Part of the Department of Industry and Commerce. Acts as the center for research on the manufacturing and commercial sectors of the Australian economy. BIE has a council of members from business, academia, and labor to advise the Minister of the Department.	Concentrates on long-term industrial policy. Reports are distributed widely to industry groups, educational institutions, and government agencies.
Department of Trade	Advises the Prime Minister on trade matters, negotiates trade agreements, participates in trade promotion.	
Bureau of Customs	Administers much of the protectionist policies including investigating dumping complaints.	
Industries Assistance Commission	Provides the government with information on the economic and social implications of industrial assistance.	Although the government must seek the IAC's advice, it does not have to accept its recommendations.
Temporary Assistance Authority	Submits recommendations to the government within 45 days of receipt of a question on whether urgent assistance is necessary to help an industry hurt by imports.	The TAA's reports are made public only after the government's decision is announced.
Australian Conciliation and Arbitration Commission	Acts as a national tribunal in wage disputes, with its decisions often affecting a large proportion of Australian workers and industries.	Has historically encouraged union membership and is not under the government's direct control.

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"technocrats" who work primarily within the Industries Assistance Commission (IAC) and the Department of Industry and Commerce have consistently argued for several years in favor of trade liberalization, with the aim of making manufacturing more efficient (see table 3). One recent IAC report argues that the more a particular industry is protected, the less likely it is to be operating efficiently. A number of official government reports over the past several years, including the 1979 White Paper on the Manufacturing Industry, stressed the need gradually to reduce the level of import constraints in order to force firms to reduce costs and increase efficiency. At the same time, according to the IAC, most decisions on import restraints are made with the intention of preserving individual industries, and investigations focus on how changes will affect the industry in question, usually to the exclusion of all secondary effects, such as the impact on consumers and exporters.

Like the technocrats, we believe the Australian economy would benefit if the government shifts direction from protectionism and gradually reduces import restraints. Although the manufacturing sector would probably become smaller, the remaining firms would be more efficient. The domestic auto industry is already beginning to move in this direction. Ford has trimmed back and revamped its production facilities, installing robots to boost productivity. General Motors-Holden is also restructuring by phasing out some components production.

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Several Australian Government and private-sector studies indicate that a smaller and more efficient manufacturing sector would free capital and labor to move to the the mineral sector and resource-processing industries—where Australia has a competitive

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**Australia: Foreign Investment Policy**

*Any industrial strategy that the Hawke government devises will have to incorporate foreign investment policy. Foreign direct investment—which has more than doubled since 1976 to \$2.5 billion in 1982—has long played a vital role in the growth of the Australian economy, particularly in developing Australia's huge mineral resource base. In fiscal year 1981/82, for example, foreign investment accounted for nearly half of all private investment and helped to finance most of Australia's record \$8.6 billion current account deficit.* [redacted]

*After six months in office, Hawke appears to us to be continuing the former Fraser government's foreign investment policy, but with a firmer application of existing guidelines. In particular, we believe Hawke is tightening up on exceptions to the 51-percent Australian equity requirement. Canberra also is pressing for maximum Australian participation, which means foreign ownership is being limited to the share that cannot be obtained from domestic sources. The postelection decisions of the Foreign Investment Review Board (FIRB), in our judgment, underscore this stricter policy, including rejecting proposals by a US firm to acquire full ownership of a leading Australian distributor of industrial plastics and a US bank's recent bid to acquire full control of an Australian bank.* [redacted]

*The Labor government's foreign investment policy has led to growing concern among foreign investors, according to a variety of press reports. The Australian-British Trade Association, for example, recently expressed concern that the government's policy has increased uncertainty among investors and will likely result in potential investors looking elsewhere. The Hawke government is sensitive to these concerns and in our judgment has gone out of its way to reassure investors. Treasurer Paul Keating recently stated in Parliament that, while an appropriate balance between domestic and foreign investment is necessary, foreign capital has accelerated Australia's development and continues to be welcome within government guidelines. During Hawke's visit to Washington last June, Keating reaffirmed these views to the New York financial community.* [redacted]

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advantage because of its large mineral and energy resources. For example, Australia has huge reserves of bauxite—representing about one-third of the world's recoverable reserves. Although Australia now produces nearly 30 percent of the world's bauxite, it processes very little ore into aluminum. According to the Australian Bureau of Industry Economics, the Australian aluminum industry could grow rapidly with increased production catering to export markets. The Bureau argues that relatively cheap and abundant electricity will leave Australia well placed to take advantage of the expected increase in world aluminum demand at a time when new investment in the smelting capacity of other industrial countries has declined.

 [redacted]

According to industry studies, less support for manufacturing and greater emphasis on the resource sector would also allow Australia to fit more smoothly into the regional Asian economy, easing trade frictions and providing a foreign policy windfall for Canberra.<sup>7</sup> Lower import constraints would encourage developing countries in Southeast Asia to buy Australia's raw materials and processed minerals because the Australian market would be more open to their labor-intensive manufactured goods. As matters now stand, the developing Asian countries have a considerable competitive advantage in labor-intensive products that Australia probably would not be able to overcome. According to this view, increased trade with Asia would provide an engine of growth for Australia well into the 1990s, helping to offset employment losses from industrial restructuring.

 [redacted]

The technocrats also believe that there is some scope for developing selected high-tech industries. The ALP also has high hopes for high-tech industries, but their optimism appears to us to be overstated. Although Minister of Science and Technology Barry Jones has vocally supported high-tech industries, the government has yet to develop a legislative package to

<sup>7</sup> Australia's recent signing of the Closer Economic Relations (CER) agreement with New Zealand is a small step in this direction, in our judgment. Under the agreement, both countries will phase out all restrictions on bilateral trade by 1995.

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promote them. Nonetheless, there are several advanced service industries that we believe could perform well, such as computer software, where Australia already has strong expertise and is supplying advanced systems to the United States and Japan. One Australian firm recently signed a \$3.5 million contract to supply a Japanese firm with an Australian-designed software system to connect a variety of equipment into an IBM systems network. The technocrats argue that industries such as these would benefit from a more open economy and should not be protected from import competition. For its part, the computer industry itself recognizes the long-run trap of protectionism and inefficiency. According to the US Embassy, the industry has asked the government not to provide import protection, arguing that to survive the industry must remain competitive in world markets. [redacted]

#### The Disquieting Choice

In our judgment, high levels of protectionism will continue to be a drag on the rest of the economy, and Australia will pay a heavy cost in forgone economic growth by continuing on this course. Despite the resources boom of the late 1970s, the rate of growth in real disposable income per capita has stagnated since 1975, growing less than 1 percent a year. According to the Australian Industry Development Corporation (AIDC), a government-established organization to promote development, Australia's rank in the world economy—based on a measure of living standards—has dropped from fifth to 11th place in the last 20 years. The AIDC suggests that continuation of present trends will result in Australia's "quality of life" dipping below that of a number of other countries—including Singapore and Hong Kong—around the turn of the century. [redacted]

Despite the long-run benefits of reduced protectionism, a more open economy would cause a shakeout in the manufacturing sector and a temporary increase in joblessness, according to a variety of government and private-sector studies. The dilemma of choosing between short-term unemployment and protectionist

constrained economic growth is largely behind Australia's failure to develop a consensus on industrial policy in recent years, and we believe the stalemate will continue during the next few years. Nonetheless, we believe Hawke has greater potential for dealing with this tough problem than any other Australian politician today. In addition to being the most popular Prime Minister in recent memory, Hawke's extensive background in labor relations and his close association with leading businessmen will be valuable assets as his government attempts to achieve consensus on industrial policy. Hawke has already shown considerable political skill in dealing with other sensitive issues such as wages, the budget, and several foreign policy concerns. In any case, no matter what Hawke ultimately does about protectionism, he is sure to alienate some domestic interest groups. The issue is certain to continue to be politically sensitive during Hawke's tenure of office, and, in our judgment, it will still be a major political headache for his successor. [redacted]

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